

PUT YOUR MONEY WHERE YOUR MIND IS: PROTECTING THE MARKETS IN THE AGE OF POST-JOBS ACT RULE 506 OFFERINGS

*Alexis A. Geeza**

I. INTRODUCTION

On September 5, 2013, all eyes fixated once again on the Super Bowl XLVII champions, the Baltimore Ravens, as the ninety-fourth NFL season kicked off in Denver.¹ Football fans across the country would soon set their sights and their hopes on the 2014 Super Bowl. With a viewership of 108.7 million in 2013 and 111.3 million in 2012,² the Super Bowl is big business. Companies understand the value of marketing their goods and services to such vast audiences and pay a premium for the opportunity.³ One advertisement from Super Bowl XLVII starred the E*TRADE baby.⁴ In the commercial, an infant

* J.D. Candidate, 2015, Seton Hall University School of Law; M.B.A., 2012, Montclair State University; M.A., 2010, University of Connecticut; B.A., 2008, Rutgers University. I would like to express my gratitude to my faculty advisors, Professor Kristin N. Johnson and Professor Ronald J. Riccio, for their valuable recommendations and insights. I am also deeply thankful for the continued love and support of my family—in particular, Patricia and Danielle Geeza, John and Anne Hutnyan, and Paul Tewfik—both prior to and during law school.

¹ Christina Vinson, *Keith Urban, Danielle Bradbery to Kick Off 2013 NFL Season*, TASTE OF COUNTRY (Aug. 6, 2013, 12:00 PM), <http://tasteofcountry.com/keith-urban-danielle-bradbery-2013-nfl-season/>.

² David Bauder, *Ratings: Another Record for Super Bowl*, AP: THE BIG STORY (Feb. 3, 2014, 7:08 PM), <http://bigstory.ap.org/article/ratings-another-record-super-bowl>.

³ See, e.g., *Super Bowl Fast Facts*, CNN (Feb. 2, 2015, 7:08 PM), <http://www.cnn.com/2013/09/03/us/super-bowl-fast-facts/> (noting that, in 2015, a 30-second commercial cost \$4.5 million on average, compared to \$40,000 in 1967).

⁴ See Chris Choi, *NEW E-TRADE Baby Game Day Commercial—Save It—Super Bowl 2013*, YOUTUBE (Feb. 3, 2013), <https://www.youtube.com/watch?v=7LHJuq4yQWg>; see also *About Us*, E*TRADE FIN. CORP., <https://about.etrade.com/index.cfm> (last visited Mar. 23, 2015) (defining E*TRADE as “a financial services company that provides online brokerage and related products and services primarily to individual *retail* investors”) (emphasis added). Retail investors are defined as individuals who buy and sell securities on their own behalf. *Retail Investor*, INVESTOPEDIA, <http://www.investopedia.com/terms/r/retailinvestor.asp> (last visited Mar. 23, 2015). Offerings to retail investors are typically regulated and, as a result, must comply with the registration requirements that the Securities Act of 1933 (the Securities Act) imposes. See *infra* notes 18–22 and accompanying text. By contrast, securities not

speaking in an adult's voice touts E*TRADE's affordable investments and lack of hidden fees as a way for working people to save money.⁵ The baby, in taking on several different personas throughout the ad, paints a picture of a responsible investor contrasted with a spendthrift hedonist.⁶ With the advent of the Jumpstart Our Business Startups Act (the "JOBS" Act), however, the E*TRADE baby may soon face competition as a new wave of marketers begins to target retail investors.⁷

The passage of the JOBS Act on April 5, 2012 stands to forever alter Americans' approach to buying and selling,⁸ particularly with regard to securities.⁹ An exceptionally intriguing and controversial aspect of the JOBS Act is Title II, which addresses Rule 506 offerings.¹⁰ Before Title II became law, any solicitation¹¹ efforts by businesses transacting in unregistered securities had to be directed toward a target audience of high net worth individuals and institutional buyers.¹² Today, under Title II, these same companies are also permitted to solicit retail investors previously accessible only to firms like

being offered to the general public are exempted from the registration requirements. *See infra* notes 22–26 and accompanying text.

⁵ *See Choi, supra* note 4 ("Oh, this is tragic, man. Investors just like you could lose tens of thousands of dollars on their 401(k) to hidden fees. Thankfully E*Trade has low cost investments and no hidden fees. But, you know, if you're still bent on blowing this fat stack of cash, there's [sic] a couple ways you can do it . . . [there is a short break where music is played] or just go to E*Trade and save it. BOOM!").

⁶ *Id.*

⁷ *See* Halah Touryalai, *Ready for Hedge Fund Commercials? SEC to End Ad Ban*, FORBES (July 10, 2013, 11:42 AM), <http://www.forbes.com/sites/halahtouryalai/2013/07/10/ready-for-hedge-fund-commercials-sec-to-end-ad-ban/>; *see also Choi, supra* note 4; *Retail Investor, supra* note 4.

⁸ *See generally infra* Part III.

⁹ The Securities Act defines a security as, *inter alia*, "any note, stock, . . . security future, . . . bond, debenture, . . . investment contract . . . or, in general, any interest or instrument commonly known as a security" 15 U.S.C.A. § 77b(a)(1) (West 2012) (internal quotation marks omitted).

¹⁰ *See, e.g.,* 17 C.F.R. § 230.506 (2013); *infra* text accompanying note 59. The actual scope of Title II is broader, but for purposes of this Comment, it will be confined to Rule 506 offerings.

¹¹ Throughout this Comment, the terms "advertising" and "soliciting," and variations of them, will be used interchangeably. This is in line with the language of Title II itself. *See infra* text accompanying note 60 (directing the Securities and Exchange Commission (SEC) to phase out the general solicitation *and* advertising ban).

¹² In other words, only stock exchange-listed companies could advertise in hopes of raising funds from the general public. *See, e.g.,* Chance Barnett, *The Crowdfunder's Guide to General Solicitation and Title II of the JOBS Act*, FORBES (Sept. 23, 2013, 10:40 AM), <http://www.forbes.com/sites/chancebarnett/2013/09/23/the-crowdfunders-guide-to-general-solicitation-title-ii-of-the-jobs-act/>.

E*TRADE.¹³ The advertisements can theoretically reach an unlimited number of people, not just sophisticated buyers.¹⁴

Title II has the potential to be a positive step for securities regulation, but there are a multitude of concerns surrounding this change in the law that must be addressed for it to achieve preeminent status in the long run. The Securities and Exchange Commission (SEC) identifies fraud prevention and investor safety as the focal points of its immediate oversight efforts.¹⁵ The SEC's first steps toward these goals¹⁶ are encouraging, but they do not go far enough. Investor education must be at the forefront of any initiatives directed at protecting the markets. Specifically, to safeguard the markets, investors should be presented with better—not merely additional—information that has practical utility. Investors should then bear ultimate responsibility for using that information proactively.

This Comment examines Title II of the JOBS Act as it relates to Rule 506 offerings and the SEC's corresponding regulatory initiatives. It analyzes the implications of each with a view toward protecting the markets and identifies the steps that the SEC and society must take in order to meet this objective. Part II of this Comment begins with a brief discussion of the Securities Act of 1933 (the Securities Act), which, in a sense, marked the genesis of the advertising ban as it existed prior to Title II. It also provides an overview of the arguments advanced over the years in favor of the solicitation prohibition's repeal. Part III presents Title II of the JOBS Act, conceptualized as an indirect response to the contentions addressed in Part II. Part IV details how the SEC and members of the public have responded to Title II. Part V argues that the SEC has not done enough to safeguard the markets since the enactment of Title II and that investors must take on a more proactive role in this endeavor. It offers further solutions that center on investor education. Part VI concludes.

¹³ See *infra* text accompanying note 60; see also E*TRADE FIN. CORP., *supra* note 4.

¹⁴ Buyers, however, must be accredited in order to invest in unregistered securities. *Infra* note 63 and accompanying text. For a discussion on the differences between sophisticated and accredited investors, see generally *infra* text accompanying notes 159–166.

¹⁵ See *infra* Part IV.A.

¹⁶ See *infra* Part IV.A. The SEC has enacted a regulation to prevent “bad actors” from advertising to the population as a whole if they are likely to perpetuate fraud in doing so. 17 C.F.R. § 230.506(d) (2013). The SEC has also proposed rules that would require issuers to divulge more information to prospective investors. Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44,806–01 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 230, 239).

II. HISTORICAL BACKGROUND FOR TITLE II

A. *The Securities Act of 1933*

Before focusing on the advertising ban, it is first necessary to understand how members of the public learn about securities. Such learning occurs, in no small part, through operation of the Securities Act. Spurred by the stock market crash of 1929 and dubbed “the first major piece of federal legislation regarding the sale of securities,”¹⁷ the Securities Act aims to foster a culture of full disclosure in the marketplace, for the benefit of the population as a whole and investors in particular.¹⁸ The Securities Act’s originators believed that requiring those issuing securities to divulge all material information related to their *public* offerings would insulate the universe of prospective buyers from fraudulent investment schemes.¹⁹ In this manner, the legislature intended the Securities Act to bridge the knowledge gap between securities purchasers and sellers.²⁰

The disclosures of material information that the Securities Act requires appear in the form of registration statements that issuers must file with the SEC.²¹ Not all classes of transactions require a registration statement, however, and issuers may execute qualifying purchases and sales even though the underlying securities are unregistered.²²

¹⁷ *Securities Act of 1933*, INVESTOPEDIA, <http://www.investopedia.com/terms/s/securitiesact1933.asp> (last visited Jan. 3, 2014).

¹⁸ See, e.g., *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953); *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476, 480–81 (9th Cir. 1973).

¹⁹ See, e.g., *Ralston Purina Co.*, 346 U.S. at 124; *Glenn W. Turner Enters., Inc.*, 474 F.2d at 480–81.

²⁰ *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 549 (E.D.N.Y. 1971).

²¹ 15 U.S.C.A. § 77f(a) (West 2012). Registration statements must discuss thirty-two categories of information, contained in Schedule A, for transactions involving domestic securities. *Id.* § 77g(a)(1); see also 15 U.S.C.A. § 77aa (West 1998). These include, *inter alia*, “the location of the issuer’s principal business office . . . a statement of the capitalization of the issuer . . . [and] the price at which it is proposed that the security shall be offered to the public or the method by which such price is computed . . .” § 77aa. The public can access the information within a registration statement after it is filed. 15 U.S.C.A. § 77f(d). Importantly, the transactions described in the registration statement cannot be executed until the SEC approves said statement. *Id.* § 77e(a).

²² § 77d. Despite the fact that exempt offerings do not need to be registered, issuers must still file an electronic Form D notice of sales with the SEC. 17 C.F.R. § 239.500(a)(1), (b)(1) (2012). Form D is brief and requests identifying information about the company’s executives as well as “the size of the offering and the date of first sale.” *Form D*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/answers/formd.htm> (last visited Apr. 5, 2015); see also *infra* notes 79–80 and accompanying text (discussing the SEC’s proposed changes to Form D).

Categorically, “transactions by an issuer not involving any *public* offering” are excused from the registration statement mandate,²³ a notion referred to as the private placement exemption. The private placement exemption covers three types of offerings which are laid out in Regulation D, promulgated by the SEC.²⁴ Although the ability to forgo filing a registration statement is attractive to issuers, this benefit did not always come without a cost. When enacted, Regulation D prohibited issuers applying for an exemption²⁵ and those acting on their behalf from using “general solicitation or general advertising” to appeal to investors.²⁶ This caveat, though well-intentioned, ignited an ongoing debate driving at its very necessity and viability.

²³ § 77d(a)(2) (emphasis added). By way of example, hedge funds have historically relied on the private placement exemption, unlike mutual funds. William K. Sjostrom, Jr., *Rebalancing Private Placement Regulation*, 36 SEATTLE U. L. REV. 1143, 1147 (2013) [hereinafter Sjostrom, *Rebalancing*]. The vast majority of hedge fund managers enjoy existing relationships with their investors; they do not seek them out. See, e.g., Abraham J.B. Cable, *Fending for Themselves: Why Securities Regulations Should Encourage Angel Groups*, 13 U. PA. J. BUS. L. 107, 134 (2010).

²⁴ 17 C.F.R. § 230.500(a) (2013); see also *Investor Bulletin: Private Placements under Regulation D*, U.S. SEC. EXCH. COMM’N (Sept. 24, 2014), http://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html.

²⁵ The Regulation D exemptions include Rules 504, 505, and 506. *Id.* §§ 230.504–230.506. In general, these exemptions involve either a small monetary transaction or a small number of investors. *Id.* Under Rule 504, issuers raising no more than \$1,000,000 through securities may sell to an unlimited number of buyers without completing a registration statement. *Id.* § 230.504; see also WILLIAM A. KLEIN, J. MARK RAMSEYER & STEPHEN M. BAINBRIDGE, *BUSINESS ASSOCIATIONS* 413 (Robert C. Clark et al. eds., 8th ed. 2012); *Rule 504 of Regulation D*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/answers/rule504.htm> (last visited Nov. 4, 2013). Rule 505 permits issuers not raising more than \$5,000,000 through securities to sell to up to thirty-five buyers without completing a registration statement. § 230.505; see also KLEIN, RAMSEYER & BAINBRIDGE, *supra*, at 413; *Rule 505 of Regulation D*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/answers/rule505.htm> (last visited Nov. 4, 2013). Under Rule 506, issuers raising more than \$5,000,000 through securities may sell to up to thirty-five buyers without completing a registration statement, so long as the buyers pass investor sophistication tests. § 230.506; see also KLEIN, RAMSEYER & BAINBRIDGE, *supra*, at 413; *Rule 506 of Regulation D*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/answers/rule506.htm> (last visited Nov. 4, 2013). Rule 506 is most critical for purposes of this Comment.

²⁶ 17 C.F.R. § 230.502(c) (2008). General solicitations and general advertisements included not only newspaper and television communications, but also seminars in which participants were invited by those means. *Id.* Given the dearth of publicly available information, those considering hedge funds as investments typically looked to limited index reports and due diligence inspections. Cary Martin, *Is Systemic Risk Prevention the New Paradigm? A Proposal to Expand Investor Protection Principles to the Hedge Fund Industry*, 86 ST. JOHN’S L. REV. 87, 118 (2012).

*B. The Rationale for the Solicitation Prohibition and Arguments
Advanced in Favor of Its Repeal*

Scholars construe the rationale for this advertising prohibition, applied to private placement issuers, as both facilitating SEC enforcement efforts and maintaining investor confidence.²⁷ In terms of enforcement efforts, if issuers are not allowed to solicit potential buyers and proceed to engage in large-scale advertising, then they may be more likely to attract the attention of the SEC.²⁸ With respect to investor confidence, investors' faith in the system may be undermined if they are continually met with a confusing barrage of solicitations in the marketplace.²⁹ Categorically banning advertisements, then, may protect buyers from accidentally investing in "risky" private funds, since it will be more difficult for purchasers to identify these ventures on their own.³⁰

Notwithstanding the concerns that the advertising ban attempted to guard against, opponents have advanced a number of arguments over the years in support of its repeal, for both procedural and substantive reasons. On the procedural side, states have much flexibility to determine how to frame their private placement exemptions to align with Regulation D.³¹ The resulting procedural variation across states militates against the goal of uniform investor protections.³² For example, if New Jersey structures its private placement exemptions in one way and Florida does so in another, then the formula for Regulation D compliance could conceivably differ between the two states, such that New Jersey investors will have a distinct experience from Florida investors.

On the substantive side, a primary justification for lifting the solicitation prohibition is to facilitate the exchange of information to more accurately reflect the realities of the marketplace. This objective stands to benefit three groups: (1) investors; (2) entities; and (3)

²⁷ See generally *infra* Part IV.B.1.

²⁸ William K. Sjostrom, Jr., *Relaxing the Ban: It's Time to Allow General Solicitation and Advertising in Exempt Offerings*, 32 FLA. ST. U. L. REV. 1, 42 (2004) [hereinafter Sjostrom, *Relaxing*].

²⁹ Rory B. O'Halloran, *An Overview and Analysis of Recent Interest in Increased Hedge Fund Regulation*, 79 TUL. L. REV. 461, 478 (2004).

³⁰ Joseph Lanzkron, *The Hedge Fund Holdup: The SEC's Repeated Unnecessary Attacks on the Hedge Fund Industry*, 73 BROOK. L. REV. 1509, 1545–46 (2008); see also Martin, *supra* note 26, at 118.

³¹ *Deregulating Capital Markets: Hearing on H.R. 2131 Before the Subcomm. on Telecomm. & Fin. of the H. Comm. on Commerce*, 104th Cong. (1995) (statement of Dee R. Harris, President, N. Am. Sec. Admin. Ass'n), available at 1995 WL 722354.

³² *Id.*

regulators. First, one commenter construes the advertising ban as the driving force behind the general lack of understanding surrounding private placements as investment tools.³³ For example, if hedge funds never release television commercials, then people will be less inclined to consider them as a financial strategy, let alone be able to distinguish a hedge fund from a mutual fund. Individuals who “may never actually purchase securities”³⁴ thus stand to profit from an enhanced understanding of how private placements operate.³⁵

Second, and beyond the ambit of individual investors, introducing more solicitations into the marketplace may increase competition between entities; as they vie for investors and attempt to attract them, entities may begin charging lower performance fees in an effort to increase their appeal to prospective investors.³⁶ For their part, investors—armed with more material—will have the capacity to make better-informed decisions about where to allocate their money, rather than simply choosing the first issuer they come in contact with.

Third, if additional information begins to flood the marketplace in the aftermath of the solicitation ban’s repeal, then regulatory bodies are also poised to profit. From the regulators’ perspective, it will be easier to ascertain whether a particular private placement is abusing investors, since regulators will be able to uncover its strategy by the content of its advertisements.³⁷ If solicitations are available for inspection, then the opportunity to move away from limited index reports and due diligence inspections (both of which require significant time and money) will help regulatory bodies to realize cost savings and to complete their investigative efforts more quickly.³⁸ Though expensive, limited index reports and due diligence inspections generally produce unreliable information for anyone

³³ O’Halloran, *supra* note 29, at 478. By contrast, some suggest that because accredited investors have the capacity to look out for their own financial interests, the prohibition against issuer solicitations does not have any noticeable effect on them. See Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1615 (2013).

³⁴ David M. Lynn & Anna T. Pinedo, *A Quick Guide to the JOBS Act*, PRACTICAL LAW CO. 1, 5 (2012), <http://www.mofo.com/files/Uploads/Images/120416-PLI-Quick-Guide-JOBS-Act.pdf> [hereinafter Lynn & Pinedo, *Quick*].

³⁵ Alexander R. Roche, *The Regulator Strikes Back: A Look at the SEC’s Most Recent Attempt to Regulate Hedge Funds and What It Missed*, 33 U. DAYTON L. REV. 145, 178 (2007). In particular, having additional knowledge at one’s disposal can lead to better decision making. *Id.* at 176.

³⁶ O’Halloran, *supra* note 29, at 489.

³⁷ Roche, *supra* note 35, at 179.

³⁸ Martin, *supra* note 26, at 118.

attempting to determine the benefits of investing in a particular hedge fund.³⁹

A final argument in favor of the solicitation ban's repeal reflects the commonly espoused economic reality "that the key to selling a product is marketing."⁴⁰ The prohibition is especially burdensome to businesses that lack large-scale advertising budgets. In fact, some scholars note that "[t]here is no greater impediment to the ability of small companies to raise capital under the securities laws than the SEC rules against general solicitation and advertising."⁴¹ Specifically, small issuers often experience difficulty locating brokers who are willing to assist them in selling their securities, and so the prohibition grinds to a halt their already modest attempts at solicitation.⁴²

Given the irrefutable fact that today's global marketplace relies heavily on advertising,⁴³ lifting the ban is readily viewed as an attempt to keep pace with the times⁴⁴ and to enable all entities to fulfill what business necessity often demands. The act of soliciting cannot be divorced from the notion of capturing the public's attention. Indeed, whether the advertising ban serves any purpose other than to ensure that certain sales remain private is a subject of intense discussion.⁴⁵

³⁹ *Id.*

⁴⁰ Sjostrom, *Relaxing*, *supra* note 28, at 33. U.S.-based companies spent 10.4% of their annual revenue for 2012 on general marketing activities. *Key Findings From U.S. Digital Marketing Spending Survey, 2013*, GARTNER (Mar. 6, 2013), <http://www.gartner.com/technology/research/digital-marketing/digital-marketing-spend-report.jsp>. On average, the surveyed organizations expected to devote 5.7% more of their 2013 budgets to marketing. *Id.*

⁴¹ Stuart R. Cohn & Gregory C. Yadley, *Capital Offense: The SEC's Continuing Failure to Address Small Business Financing Concerns*, 4 N.Y.U. J. L. & BUS. 1, 36 (2007).

⁴² Rutheford B. Campbell, Jr., *The Plight of Small Issuers (and Others) Under Regulation D: Those Nagging Problems That Need Attention*, 74 KY. L.J. 127, 142-43 (1985).

⁴³ See Peter Lattman, S.E.C. Lifts Advertising Ban on Private Investments, N.Y. TIMES DEALBOOK (July 10, 2013, 4:04 PM), http://dealbook.nytimes.com/2013/07/10/s-e-c-lifts-advertising-ban-on-private-investments/?_r=1. Additionally, mutual funds have long been allowed to solicit investors. Touryalai, *supra* note 7; see, e.g., Choi, *supra* note 4. Mutual funds, unlike hedge funds, cater to retail rather than to sophisticated investors. E*TRADE FIN. CORP., *supra* note 4.

⁴⁴ Hedge funds and other private placements are no longer the exclusive domain of institutional investors. Lattman, *supra* note 43. Hedge fund managers are also spending increasingly more time in the *public* eye and are consequently being viewed as more accessible. See *id.* (noting that Och-Ziff Capital Management, a hedge fund, is a *public* company).

⁴⁵ Sjostrom, *Relaxing*, *supra* note 28, at 40.

III. TITLE II OF THE JOBS ACT

Part II of this Comment presented a number of persuasive arguments in support of eliminating the solicitation ban for private placements. It is interesting to note, then, that lawmakers did not have this as their end-goal when drafting the legislation that ultimately lifted the advertising prohibition. Rather, this change in the law was ancillary to a more general objective, namely, job creation by small businesses.⁴⁶ Representative Stephen Lee Fincher (R-TN) introduced the Reopening American Capital Markets to Emerging Growth Companies Act of 2012 (“Emerging Growth Companies Act”) in the House on December 8, 2011.⁴⁷ He expressed his rationale for the bill: “Burdensome costs are discouraging companies from going public, which deprives firms of the capital needed to expand their businesses and hire more American workers. . . . ‘[O]ne-size-fits-all’ laws and regulations have changed the nature of the United States’ capital markets”⁴⁸

Over the course of the nearly four months that the House and Senate deliberated the Emerging Growth Companies Act, lawmakers began referring colloquially to the Act and the other bills alongside it as the JOBS Act.⁴⁹ Repealing the solicitation ban also became a hot-button issue with Representative Kevin McCarthy’s (R-CA) proposal that only Rule 506 offerings under Regulation D be allowed to advertise.⁵⁰ He sought further to clarify that a company’s choosing to solicit to the public does not render its offering public.⁵¹ In addition, Representative Patrick McHenry (R-NC) recommended that private shares be made available to accredited investors via trading platforms.⁵² These proposals took shape in the eventual law, which instructed the SEC to permit solicitations for private offerings falling under the Rule 506 umbrella, so long as only accredited investors are permitted to buy the securities involved.⁵³

⁴⁶ See, e.g., 157 CONG. REC. E2210–04 (daily ed. Dec. 8, 2011) (statement of Hon. Stephen Lee Fincher).

⁴⁷ *Id.*

⁴⁸ *Id.*; see also David M. Lynn & Anna T. Pinedo, *The JOBS Act*, MORRISON FOERSTER 1, 1 (2012), <http://www.mofo.com/files/Uploads/Images/120326-TheJOBS-Act.pdf>.

⁴⁹ Brett Logiurato, *Obama Is About to Sign the JOBS Act: Here Are the Major Points of the New Law*, BUS. INSIDER (Mar. 27, 2012, 5:21 PM), <http://www.businessinsider.com/here-are-the-major-points-of-the-jobs-act-2012-3>.

⁵⁰ H.R. REP. NO. 112-409, pt. 10, at 3 (2012).

⁵¹ *Id.*

⁵² *Id.* at pt. 11.

⁵³ See *infra* text accompanying notes 60–63.

The law achieved the “increasingly rare legislative victory”⁵⁴ of bipartisan support, passing 380 to 41 in the House⁵⁵ and 73 to 26 in the Senate.⁵⁶ President Obama signed the JOBS Act into law on April 5, 2012,⁵⁷ the stated purpose of which was “[t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.”⁵⁸ Title II, termed “Access to Capital for Job Creators,” highlights the new role that advertising is to play in Rule 506 offerings in Section 201: “Modification of Exemption.”⁵⁹ Section 201 directs the SEC to revise its rules within ninety days to lift the general solicitation and advertising ban for Rule 506 offerings,⁶⁰ marking the end of an eighty-year prohibition⁶¹ by permitting certain private placements to raise funds in the open market.⁶² Title II, however, does not permit just anyone to take part in the transactions. Rather, it requires the SEC to mandate in its new rule that everyone purchasing the securities be an accredited investor.⁶³ The SEC is empowered under Title II to require

⁵⁴ Seung Min Kim, *JOBS Act Passes Congress, Heads to Obama*, POLITICO (Mar. 27, 2012, 2:22 PM), <http://www.politico.com/news/stories/0312/74539.html> (quoting House Majority Leader Eric Cantor (R-VA)).

⁵⁵ *House Vote 132 - Final Passage for JOBS Bill*, N.Y. TIMES POLS. (Mar. 27, 2012, 2:17 PM), <http://politics.nytimes.com/congress/votes/112/house/2/132>.

⁵⁶ Edward Wyatt, *Senate Passes Start-Ups Bill, With Amendments*, N.Y. TIMES BUS. DAY (Mar. 22, 2012), http://www.nytimes.com/2012/03/23/business/senate-passes-start-ups-bill-with-amendments.html?_r=0.

⁵⁷ President Obama Signs the JOBS Act, THE WHITE HOUSE (Apr. 5, 2012, 7:24 PM), <http://www.whitehouse.gov/photos-and-video/video/2012/04/05/president-obama-signs-jobs-act>.

⁵⁸ Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

⁵⁹ *Id.* at 313–14.

⁶⁰ *Id.*

⁶¹ See, e.g., *How General Solicitation Works*, CROWDFUNDER BLOG, <http://www.crowdfunder.com/p/how-general-solicitation-works/> (last visited Feb. 2, 2015); Dave Michaels, *SEC Votes to Ease 80-Year-Old Ban on Private-Investment Ads*, BLOOMBERG (July 10, 2013, 1:36 PM), <http://www.bloomberg.com/news/2013-07-09/sec-set-to-lift-80-year-old-ban-on-advertising-by-hedge-funds.html>; Lattman, *supra* note 43. Even President Obama has echoed the historical significance of Title II, indicating as he signed the bill that “[A] lot’s changed in 80 years, and it’s time our laws did as well.” President Barack Obama, Remarks on Signing the Jumpstart Our Business Startups Act (Apr. 5, 2012) (transcript available at <http://www.mofo.com/files/Uploads/Images/DCPD-201200249.pdf>).

⁶² See generally 17 C.F.R. § 230.506 (2013); *How General Solicitation Works*, *supra* note 61. This change has no effect on Rule 506 offerings’ being classified as private; they will continue to be deemed private regardless of whether their issuers choose to advertise to the public or not. See *supra* text accompanying note 51.

⁶³ See Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201, 126 Stat. 306, 313 (2012); Lynn & Pinedo, *Quick*, *supra* note 34, at 5.

2015]

COMMENT

591

issuers to take reasonable steps—that it identifies—to determine whether purchasers are accredited.⁶⁴ Thus, as the literal language of the law indicates, the SEC is afforded much discretion to effectuate Title II.

IV. THE SEC’S AND SOCIETY’S RESPONSES TO TITLE II OF THE JOBS ACT

A. *The SEC’s Response to Title II*

July 10, 2013 was a busy day for the SEC.⁶⁵ It began by doing exactly what Title II called for. First, the SEC amended Rule 506 to enable issuers relying on that Regulation D exemption to advertise or solicit their securities offerings.⁶⁶ Second, the SEC imposed the condition that all purchasers be accredited and that issuers take reasonable steps to guarantee that buyers are accredited.⁶⁷ The SEC, however, decided to take this several steps further. Namely, it

⁶⁴ See § 201, 126 Stat. at 313–14.

⁶⁵ Press Release, SEC, SEC Approves JOBS Act Requirement to Lift General Solicitation Ban: Commission Also Adopts Rule to Disqualify Bad Actors from Certain Offerings and Proposes Rules to Enable SEC to Monitor New Market and Bolster Investor Protections (July 10, 2013), available at <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539707782#.UvPmgrQi-Vo>.

⁶⁶ See *Eliminating the Prohibition against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, U.S. SEC. & EXCH. COMM’N 1, 17 (July 10, 2013), <http://www.sec.gov/rules/final/2013/33-9415.pdf>.

⁶⁷ *Id.* Amended Regulation D proffers four “non-exclusive and non-mandatory methods” to ascertain whether an individual purchasing securities is an accredited investor: (1) *Income-based*: reviewing any Internal Revenue Service form that reports income for the past two years and obtaining written verification from the prospective investor that she reasonably expects to achieve at least the same level of income in the current year; (2) *Net worth-based*: examining, *inter alia*, bank statements or credit reports from the past three months and acquiring written verification from the prospective investor that he has revealed all liabilities that could factor into a determination of his net worth; (3) *Written confirmation from a verifying person or entity*: obtaining written verification from, *inter alia*, a registered broker-dealer or certified public accountant confirming that he has taken reasonable steps to verify the prospective investor’s accreditation status within the past three months, and that the prospective investor is accredited; or (4) *Certification from the purchaser himself*: procuring verification from a prospective investor that he is accredited at the time the security is sold, provided that the investor allotted funds to the issuer prior to September 23, 2013 and continues to hold the same offering. 17 C.F.R. § 230.506(c)(2)(ii)(A)–(D) (2013). If using method (1), *supra*, then the individual’s annual income must exceed \$200,000 (individually) or \$300,000 (with a spouse). § 230.501(a)(6). If using method (2), *supra*, then the individual’s own net worth—or joint net worth with a spouse—must exceed \$1,000,000. *Id.* § 230.501(a)(5); see also § 201, 126 Stat. at 313. Any of these methods, however, is an acceptable means of verifying accredited investor status, provided that the issuer does not know that the buyer is unaccredited. See, e.g., § 230.506(c)(2)(ii); § 201, 126 Stat. at 313–14. Crucially, the issuer is not mandated to use any of the four methods from § 230.506(c)(2)(ii)(A)–(D). § 230.506(c)(2)(ii)(D).

identified two critical issues surrounding Title II's implementation that are worthy of attention: 1) vetting the private placements choosing to solicit⁶⁸ and 2) protecting investors.⁶⁹

1. Vetting the Private Placements Choosing to Solicit

In addition to lifting the advertising ban, the SEC amended Rule 506 to comply with Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.⁷⁰ Although this action did not tie directly to the solicitation prohibition, it served to bar "felons and other 'bad actors'" from relying on the Rule 506 exemption.⁷¹ Under the new rule, issuers and covered individuals fall under the felons and other bad actors umbrella if they have a "disqualifying event,"⁷² which generally contains some element of fraud:

[W]e recognize the concerns raised by a number of commenters that a general solicitation for a Rule 506(c) offering would attract both accredited and non-accredited investors and *could result in an increase in fraudulent activity in the Rule 506 market*, as well as an increase in unlawful sales of securities to non-accredited investors.⁷³

Rule 506 enumerates eight disqualifying events that will preclude a person from tendering offerings of securities under the rule.⁷⁴ It will,

⁶⁸ See *infra* notes 70–76 and accompanying text.

⁶⁹ See *infra* notes 77–95 and accompanying text.

⁷⁰ Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, 78 Fed. Reg. 44,730-01, 44,730 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 200, 230, 239).

⁷¹ *Id.*

⁷² § 230.506(d) (noting that covered individuals include, *inter alia*, people compensated for advertising to buyers, general partners or managing members of the advertiser, and directors and officers taking part in the advertiser's offering or in the advertiser's general partners' or management members' offering); see also *Fact Sheet: Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/news/press/2013/2013-124-item2.htm> (last modified July 10, 2013).

⁷³ Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44,806-01, 44,807 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 230, 239) (emphasis added).

⁷⁴ The eight disqualifying events are: (1) *Criminal convictions* entered within the last five years (in the case of issuers) or within the last ten years (in the case of other covered persons) that relate to the purchase or sale of securities, false SEC filings, or business conduct; (2) *Court orders, judgments, or decrees* entered within the past 5 years that are in effect at the time of sale and that relate to the purchase or sale of securities, false SEC filings, or business conduct; (3) *Final orders* issued by, *inter alia*, federal banking regulators that either prevent the issuer from associating with a regulated entity or participating in the business of purchasing or selling securities; (4) *SEC disciplinary orders* that suspend or revoke registration, or that limit the issuer's activities;

however, be a defense that the individual could not have known, even through the exercise of reasonable care, that he or she was subject to a disqualifying event.⁷⁵ Although disqualifying events prior to the rule's effective date of September 23, 2013 will not count, issuers must notify purchasers in writing of any such events that took place prior to the effective date.⁷⁶

2. Protecting Investors

Also on July 10, 2013, the SEC proposed a rule addressing concerns over the manner in which information related to Rule 506 offerings is presented to investors.⁷⁷ The proposed rule requires issuers who have not filed Form D to file an initial Form D at least fifteen calendar days before commencing advertising efforts for the offering.⁷⁸ Regarding the actual content of Form D, the SEC proposed an update to Item 6 for those filling out the form to indicate whether they are relying on Rule 506(c).⁷⁹ It also proposed adding six new items to the form.⁸⁰ Under the proposed rule, issuers who have not complied with the Form D filing requirements within the past five years are barred,

(5) *SEC cease and desist orders* relating to, *inter alia*, scienter-based antifraud provisions of the securities laws, entered within the past 5 years and in effect at the time of sale; (6) *Suspension or expulsion* from becoming a member in, or associating with, a registered national securities exchange or securities association; (7) *Refusal and stop orders, and orders suspending Regulation A*, for registration statements entered within the past 5 years; or (8) *False representation orders* by the United States Postal Service.

§ 230.506(d)(1)(i)–(viii).

⁷⁵ *Id.* § 230.506(d)(2)(iv).

⁷⁶ *Id.* § 230.506(e).

⁷⁷ *Fact Sheet: Proposing Amendments to Private Offering Rules: SEC Open Meeting*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/news/press/2013/2013-124-item3.htm> (last visited Jan. 5, 2013).

⁷⁸ Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,810–11.

⁷⁹ *Id.* at 44,814; *see also Form D*, *supra* note 22; *Form D*, U.S. SEC. & EXCH. COMM'N 1, 2 (2013), <http://www.sec.gov/about/forms/formd.pdf>.

⁸⁰ New items 17–22 include, *inter alia*,

The number and types of accredited investors that purchased securities in the offering . . . if the issuer used a registered broker-dealer in connection with the offering, whether any general solicitation materials were filed with FINRA . . . for Rule 506(c) offerings, the types of general solicitation used or to be used (e.g., mass mailing . . . public Web sites, social media . . .)

See Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,815; *see also* Brandon J. Rees, *File No. S7-06-13*, AFL-CIO 1, 3 (2013), <http://www.sec.gov/comments/s7-06-13/s70613-423.pdf> (noting that the information provided in the legends on the marketing materials—*infra* note 82 and accompanying text—does not adequately capture the risks associated with private fund investments).

for one year, from relying on Rule 506.⁸¹ Filling out paperwork correctly thus takes on monumental importance, as a mistake will mean the difference between being allowed to engage in general solicitation and being barred from doing so.

The SEC proposed further that a number of conditions be imposed on the written advertising materials employed by issuers. One requirement is that issuers include prominent legends on all written solicitations.⁸² These legends, though not conditions of Rule 506,⁸³ inform investors “as to whether they are qualified” and of certain investment risks.⁸⁴ Some commenters, however, have suggested that additional constraints be imposed on hedge funds, venture capital funds, and private equity funds⁸⁵ that will be advertising, in the form of specific content requirements and restrictions:⁸⁶

Because investors consider performance to be one of the most significant factors when evaluating investments, we are concerned that private funds [sic] presenting non-current performance data *may confuse, and even mislead, investors* regarding the fund’s current performance, particularly if the fund’s performance has changed significantly after the period reflected in the advertisement.⁸⁷

⁸¹ Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,817.

⁸² The legends would indicate that securities may only be sold to accredited investors as defined and stipulate: (1) that “securities are being offered in reliance on an exemption from the registration requirements of the Securities Act”; (2) that the SEC has not passed on the merits of the offering; (3) that investors are not to assume that resale is an option; and (4) that investing in securities involves an inherent degree of risk that investors must be prepared to bear. *Id.* at 44,821–22.

⁸³ *Id.* at 44,823. *But see* David Certner, *Amendments to Regulation D, Form D and Rule 156 Under the Securities Act*, AARP 1, 4 (2013), <http://www.sec.gov/comments/s7-06-13/s70613-429.pdf>.

⁸⁴ *See* Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,822.

⁸⁵ While mutual funds are heavily regulated, hedge and private equity funds are not. Thomas C. Pearson & Julia Lin Pearson, *Protecting Global Financial Market Stability and Integrity: Strengthening SEC Regulation of Hedge Funds*, 33 N.C.J. INT’L L. & COM. REG. 1, 4 (2007). The SEC, and FINRA, to a lesser extent, regulate mutual funds. Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1030 (2009). Because of this oversight, mutual funds do not often rely on the speculative practices, such as short-selling, that hedge funds do. Office of Investor Educ. and Advocacy, *Investor Bulletin: Hedge Funds*, U.S. SEC. & EXCH. COMM’N 1, 1 (2013), http://www.sec.gov/investor/alerts/ib_hedgefunds.pdf; *see also* Anita K. Krug, *Financial Regulatory Reform and Private Funds*, BERKELEY CTR. FOR L., BUS. & ECON. 1, 6 (2009) [hereinafter Krug, *Financial*] (noting that private funds can pursue virtually any investment strategy).

⁸⁶ *See* Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,822.

⁸⁷ *Id.* at 44,823 (emphasis added).

With this view in mind, the SEC recommended a mandate that private funds include a legend on any written advertising materials not subject to the provisions of the Investment Company Act.⁸⁸ In addition to legends on these funds' advertising materials, the SEC proposed a number of disclaimers under Rule 509(c), to be made by funds citing performance data: (1) that the data represents past performance and is not a perfect predictor of future outcomes; (2) that current performance may not match the data in the solicitation materials; (3) that private funds are not required to follow any standard methodology; and (4) that a one-to-one comparison of private funds' performance may not be possible.⁸⁹ In addition, the private funds the proposed rule targets must provide a phone number or website through which prospective investors can access up-to-date performance data.⁹⁰ The SEC also encourages a need for private funds to be mindful of the types of sales literature that are considered to be "misleading for purposes of the federal securities laws."⁹¹

Finally, under proposed Rule 510T under Regulation D, issuers relying on Rule 506(c) will be required to submit their written advertising materials to the SEC no later than the date the materials are first used in conjunction with the offering.⁹² The comment period for these proposed rules closed on November 4, 2013.⁹³ The discussion is far from over, however, as society continues to respond to these changes in earnest.⁹⁴ A final rule is expected in October 2015.⁹⁵

⁸⁸ *Id.* The Investment Company Act includes, *inter alia*, limitations on leverage "and requirements regarding independent board members" that are inapplicable to private funds. *Id.*

⁸⁹ *Id.* at 44,822–23.

⁹⁰ *Id.* at 44,823.

⁹¹ Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,825.

⁹² *Id.* at 44,828. This proposed rule would only exist for two years after its effective date in order to give the SEC an opportunity to assess market practices. *Id.*

⁹³ Amendments to Regulation D, Form D and Rule 156; Re-Opening of Comment Period, 78 Fed. Reg. 61,222-01, 61,223 (proposed Oct. 3, 2013) (to be codified at 17 C.F.R. pts. 230, 239).

⁹⁴ See *infra* notes 96–129 and accompanying text.

⁹⁵ *View Rule*, OFFICE OF INFO. AND REGULATORY AFFAIRS, <http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201410&RIN=3235-AL46#> (last visited Mar. 23, 2015).

B. Society's Response to Title II

1. The Opposition's View

The SEC's actions have not received unanimous support⁹⁶—even within the SEC itself. Commissioner Aguilar vehemently opposed lifting the advertising ban.⁹⁷ He predicates his divergent view on the danger of fraud, specifically, that scammers will use any number of solicitation tools to generate compelling, imaginative (and dishonest) sales pitches that will ultimately harm investors.⁹⁸ The lack of available data on the percentage of accredited investors who are susceptible to the pull of glossy advertisements⁹⁹ leaves unanswered the question of whether investors are better- or worse-off following the implementation of Title II of the JOBS Act.

While some believe that any hysteria surrounding the new law is much ado about nothing,¹⁰⁰ a sizeable segment of society agrees with Commissioner Aguilar. To begin, up until this point, the entities prohibited from advertising to the general population have enjoyed a certain mystique by virtue of their being inaccessible to everyday people.¹⁰¹ Title II of the JOBS Act stands to increase the visibility of

⁹⁶ See generally *infra* notes 101–129 and accompanying text.

⁹⁷ Lattman, *supra* note 43.

⁹⁸ Luis A. Aguilar, Comm'r, U.S. SEC. & EXCH. COMM'N, Facilitating General Solicitation at the Expense of Investors (July 10, 2013), *available at* <http://www.sec.gov/News/Speech/Detail/Speech/1370539684712#.UnPT3uKluZQ>.

⁹⁹ Thompson & Langevoort, *supra* note 33, at 1617.

¹⁰⁰ The National Venture Capital Association (NVCA), for example, does not believe that its member firms will be quick to start advertising to the general public. Jennifer Connell Dowling, *The SEC's Proposed New Rules on General Solicitation*, NVCACCESS (Sept. 25, 2013), <http://nvcaccess.nvca.org/index.php/topics/public-policy/385-the-secs-proposed-new-rules-on-general-solicitation.html>. In particular, issuers may stand to gain little from allotting resources to an innovative marketing program if they already “have an established marketing presence and a deep liquid investor base.” Sarah N. Lynch, *SEC Lifts Longtime Advertising Ban for Hedge Funds, Others*, REUTERS (July 10, 2013, 6:04 PM), <http://www.reuters.com/article/2013/07/10/us-sec-advertising-idUSBRE9690I520130710> (quoting Matthew Kaplan, partner at Debevoise & Plimpton LLP). The NVCA also believes that even if its venture capital firms decide to include advertisements in their corporate strategies moving forward, the additional requirements imposed by the SEC go too far in terms of the amount and type of material they require. Dowling, *supra*; see also Michaels, *supra* note 61 (noting that the private securities market may be weighed down by the costly new rules).

¹⁰¹ Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389, 3396 (2013). The “exotic investments” at issue include hedge funds and private equity funds. *Id.* at 3389. Hedge funds are extremely restrictive in terms of who has access to them. See generally Alan L. Kennard, *The Hedge Fund Versus the Mutual Fund*, 57 TAX LAW. 133, 134 (2003). Furthermore, hedge funds largely rely on speculative practices,

these private placements as investment tools.¹⁰² Individuals who have not had occasion to invest in hedge funds may have concluded that they are the exclusive province of the wealthy and may choose to go after them, believing that enormous returns are simply unrealistic in the retail market.¹⁰³

Even more specifically, the public sentiment surrounding “Amendments to Regulation D, Form D and Rule 156 Offerings under the Securities Act” is captured in the comment letters presented to the SEC. These letters fall into two broad categories, Type A and Type B.¹⁰⁴ Forty-nine individuals and entities submitted some variation of Letter Type A,¹⁰⁵ the main concern of which is startups’ ability to raise money publicly.¹⁰⁶ Multiple factors drive this worry:

- Startups that break the rules will remove any chance of raising capital for themselves.¹⁰⁷
- Startups will try to raise money privately due to the onerous nature of the rules.¹⁰⁸
- Startups will face difficulty “notify[ing] the SEC in advance, fil[ing] documents every time there is a new communication with investors and includ[ing] boilerplate with every communication” if bankers are unavailable to aid them in their fundraising efforts.¹⁰⁹

Letter Type A advocates favor permitting third parties to complete SEC filings for startups, requiring boilerplate language only when discussing the terms of financing, and breaking the connection

such as short-selling. Office of Investor Educ. & Advocacy, *Investor Bulletin: Hedge Funds*, U.S. SEC. & EXCH. COMM’N 1, 2 (2013), http://www.sec.gov/investor/alerts/ib_hedgefunds.pdf; see also Krug, *Financial*, *supra* note 85, at 6.

¹⁰² Rodrigues, *supra* note 101, at 3396. Significantly, the North American Securities Administrators Association compiles a list of the top ten investor traps every year, and private placements routinely make the list. A. Heath Abshire, *NASAA Comments in Response to Release No. 33-9354 (File No. S7-07-12), “Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A,”* NASAA 1, 2 (2012), <http://www.sec.gov/comments/s7-07-12/s70712-92.pdf>.

¹⁰³ Rodrigues, *supra* note 101, at 3413.

¹⁰⁴ *Comments on Proposed Rule: Amendments to Regulation D, Form D and Rule 156 under the Securities Act*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/comments/s7-06-13/s70613.shtml> (last visited Jan. 31, 2014).

¹⁰⁵ *Id.*

¹⁰⁶ If unable to raise adequate funds, then a startup with otherwise fantastic potential may be driven out of business. *Letter Type A*, U.S. SEC. & EXCH. COMM’N, <http://www.sec.gov/comments/s7-06-13/s70613-48.htm> (last visited Jan. 31, 2014).

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

between noncompliance and elimination of any chance to subsequently raise money.¹¹⁰ These suggestions have potential to shift some of the documentation burden away from startups, to permit flexibility for the use of innovative language when appropriate, and to lessen the severity of the consequences flowing from honest or insignificant mistakes.

During the same comment period, one hundred sixty individuals and entities submitted some variation of Letter Type B.¹¹¹ Angel investor groups¹¹² in New Jersey, New York, and Connecticut spearheaded this petition, cautioning that, as a result of the SEC's new rule, both angel investing and the number of jobs available in the U.S. will decline.¹¹³ As such, the one hundred sixty endorsed the following alternatives:

- Withdraw the proposed amendments to both Regulation D and Form D.¹¹⁴
- Eradicate the notion that acquiring startup funding from family members and friends, even on a limited basis, should negatively impact startups' ability to rely on the Rule 506(c) exemption.¹¹⁵
- Define members of angel groups, and those who put forward an investment of at least \$10,000, as express categories of accredited investors.¹¹⁶
- Clarify that neither events with a capped number of attendees, e.g., demo days, nor events that are devoid of

¹¹⁰ *Id.*

¹¹¹ *Comments on Proposed Rule: Amendments to Regulation D, Form D and Rule 156 under the Securities Act*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/comments/s7-06-13/s70613.shtml> (last visited Jan. 31, 2014).

¹¹² Angel investor groups furnish "financial backing for small startups or entrepreneurs" on either a one-time or an ongoing basis and on generally favorable terms. *Angel Investor*, INVESTOPEDIA, <http://www.investopedia.com/terms/a/angelinvestor.asp> (last visited Feb. 8, 2014). In contrast to venture capitalists, angel investors' primary focus is helping fledgling businesses grow, rather than realizing high returns on their investments. *Id.*

¹¹³ *Urgent Angel Investors' Comments on Rule 506 Final & Proposed Regs*, IPETITIONS 1, 2 (2013), <http://www.ipetitions.com/petition/urgent-angel-investors-comments-on-rule-506-final/>.

¹¹⁴ *Id.* at 3. Because a startup's inadvertent rule violation will result in a shortage of funding and possibly bankruptcy, angel investors will begin to view startups as uncomfortably risky enterprises. *Id.*

¹¹⁵ *Id.* Angel investors view "the commitment of Friend [sic] and Family [as] an initial sign of the commitment and integrity of an entrepreneur." *Id.*

¹¹⁶ *Id.* at 4.

any mention of a securities offering, qualifies as a general solicitation.¹¹⁷

2. The Opposition's Response to the Support

Title II's supporters cite to the fact that issuers relying on the general solicitation allowance can only sell to accredited investors.¹¹⁸ An accredited investor, however, is defined as any individual whose annual income exceeds \$200,000.¹¹⁹ This threshold is not a high bar to meet. In fact, in 2011, roughly 6.07 million Americans earned more than \$200,000;¹²⁰ estimates also posit that "133,000 male heads of household and 143,000 female heads of household" earn more than \$200,000 annually.¹²¹ These figures do not represent a miniscule subset of the population. Opponents argue against removing the solicitation ban on grounds that it prematurely assumes that all individuals who are *accredited* for purposes of Title II of the JOBS Act are *sophisticated* as a matter of course.¹²² Wealthy senior citizens are offered as a prime example.¹²³ Even otherwise financially savvy investors may have trouble protecting themselves if the investment scheme in question is complicated enough.¹²⁴ Thus, some suggest overhauling the definition of accredited investor.¹²⁵

¹¹⁷ See *Urgent Angel*, *supra* note 113, at 4–5.

¹¹⁸ See, e.g., Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201, 126 Stat. 306, 313–14 (2012); 17 C.F.R. § 230.506(c)(2)(ii)(A)–(D) (2013).

¹¹⁹ See § 230.501(a)(6). Due to inflation, one need not be extremely well-off in order to be considered an accredited investor; a number of retail investors fit within this category. Thompson & Langevoort, *supra* note 33, at 1616.

¹²⁰ Ron Scherer, *Obama Tax Proposal: Who Makes More than \$250k, and Are They Rich?*, CHRISTIAN SCI. MONITOR (July 10, 2012), <http://www.csmonitor.com/USA/DC-Decoder/2012/0710/Obama-tax-proposal-Who-makes-more-than-250k-and-are-they-rich-video> (referring to research by the Tax Policy Center).

¹²¹ *Id.* (referencing U.S. Census data).

¹²² See, e.g., Lattman, *supra* note 43. It may be the case that bankers and lawyers are accredited investors, but the category could just as easily comprise a "rancher who is still driving a 1980s-era pickup truck. Or . . . the retiree in Florida who plays tennis every day and tells his son or daughter how to run the family business." See Scherer, *supra* note 120.

¹²³ Thompson & Langevoort, *supra* note 33, at 1618; see also David Certner, *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, AARP 1, 2 (2012), <http://www.sec.gov/comments/s7-07-12/s70712-130.pdf> (explaining that older investors are some of the most common victims of securities fraud). Moreover, cases involving unregistered securities appeared a disproportionate number of times in a 2010 NASAA study of state securities regulation enforcement actions on behalf of investors over the age of 50. *Id.*

¹²⁴ Thompson & Langevoort, *supra* note 33, at 1617.

¹²⁵ *Id.* at 1619.

To staunch opponents of the law, however, choosing to modify the conceptualization of “accredited investor” will not remedy the situation, as they likewise deem the warnings the SEC requires on marketing materials to be deficient.¹²⁶ People tend to ignore cautionary tales if they have already decided on a course of action in their minds, and a warning label will not necessarily impede advertisers from engaging in unremitted solicitation efforts.¹²⁷ With a warning label as a Band-Aid, issuers may become particularly aggressive in their marketing practices: “the combination of advertising plus continued and unfettered broker-dealer activity[] would be a disaster.”¹²⁸ To regain a degree of control over brokers, some opponents of Title II recommend placing an upper limit on how many individuals can participate in a private placement.¹²⁹

3. The Current State of Affairs

The spirited debate surrounding Title II raises the question of how, if at all, private placement issuers have changed their business strategies in the aftermath of the new law. The SEC Office of Investor Education and Advocacy issued an investor alert in September 2013 that, among other things, discusses what private placements are and the things one should consider when making private placement investment decisions.¹³⁰ This intimates that the SEC anticipated a wave of advertising that would increase the general level of interest in private placements.¹³¹ Hedge funds, private equity firms, and venture capital entities, however, have been slow to take advantage of the solicitation allowance.¹³²

¹²⁶ See generally *supra* notes 82–88 and accompanying text.

¹²⁷ Thompson & Langevoort, *supra* note 33, at 1618. Senator Levin of Michigan is concerned that there will be no limit to how hedge funds, as high-risk investments, can advertise. Associated Press, *SEC Lifts Ban on Hedge Fund Advertising*, BOS. GLOBE (July 11, 2013), <http://www.bostonglobe.com/business/2013/07/10/sec-lifts-ban-hedge-fund-advertising/EH6ce6T58xy6KiEqM3yquJ/story.html>.

¹²⁸ Jennifer J. Johnson, *Fleeing Grandma: A Regulatory Ponzi Scheme*, 16 LEWIS & CLARK L. REV. 993, 1011 (2012).

¹²⁹ *Id.*

¹³⁰ *Investor Alert: Advertising for Unregistered Securities Offerings*, U.S. SEC. & EXCH. COMM’N 1, 3 (2013), http://www.sec.gov/investor/alerts/ia_solicitation.pdf.

¹³¹ Some have posited that well-off individuals who do not have a broker will be most influenced by the ads. Allen Wastler, *What Could Save Hedge Funds? Marketing! (Maybe)*, CNBC (Sept. 21, 2013, 7:00 AM), <http://www.cnbc.com/id/101048746>.

¹³² “This is a game of dodgeball . . . and we are going to let other people get hit in the head with the ball before we start doing it.” Harvey D. Shapiro, *Why Aren’t Hedge Funds Advertising?*, NEW YORKER (Oct. 31, 2013), <http://www.newyorker.com/online/blogs/currency/2013/10/why-arent-hedge-funds-advertising.html> (quoting

In fact, only a minute number of hedge funds have begun advertising, mostly on social media sites.¹³³ Topturn Capital was the first one to issue a public advertisement;¹³⁴ it also launched an email campaign to 350 recipients.¹³⁵ Ff Venture Capital has likewise taken advantage of Title II; in October 2013, it began leveraging social media, email, and the web to target potential investors.¹³⁶ Indeed, those issuing private placements have a variety of avenues to choose from in terms of how to solicit. Dow Jones and VentureBeat, for example, tout the benefits of advertising in their private equity and venture capital publications,¹³⁷ and on their technology blog,¹³⁸ respectively. Why, then, have the entities in question largely failed to advertise?

First, hedge funds cater to a very narrow demographic: people who can afford to invest \$1,000,000 at the outset.¹³⁹ Even with this initial hurdle though, four of the six largest funds are not accepting new investors.¹⁴⁰ Second, institutional investors are a huge part of the hedge fund client base, and to appeal to them, the people pitching the fund must detail the fund's success as well as the uniqueness of its strategy—points that a solicitation, on its own, may gloss over.¹⁴¹

Anthony Scaramucci, founder and co-managing director of SkyBridge Capital, an investment firm).

¹³³ *Id.* Most of these funds have been seeking seed and early-stage capital. Dan Primack, *Why This Hedge Fund Became the First to Advertise*, CNN MONEY (Dec. 3, 2013, 3:30 PM), <http://finance.fortune.cnn.com/2013/12/03/hedge-fund-advertise/>.

¹³⁴ Primack, *supra* note 133. The two minute and forty-nine second clip analogizes a surfing technique to Topturn's investment approach: "The whole idea of that [top] turn or pivot, to stay in the energy of that wave, is very much like what Greg does in the strategy that he runs." TOPTURN CAPITAL, <http://www.topturncapital.com/> (last visited Jan. 31, 2014). Interestingly, the advertisement does not discuss how Topturn's investments perform. Primack, *supra* note 133. *See also infra* notes 181–184.

¹³⁵ Mariah Summers, *Here's the First Ever Hedge Fund Ad, Complete with a Professional Surfer*, BUZZFEED BUS. (Dec. 3, 2013, 1:25 PM), <http://www.buzzfeed.com/mariahsummers/heres-the-first-ever-hedge-fund-ad>.

¹³⁶ Russ Garland, *Ff Venture Capital Touts Fundraising Under New SEC Rules as Most VCs Hold Back*, WALL ST. J. (Oct. 11, 2013, 10:28 AM), <http://blogs.wsj.com/venturecapital/2013/10/11/ff-venture-capital-touts-fundraising-under-new-sec-rules-as-most-vcs-hold-back/>; *see also* Dan Primack, *The First VC Firm to 'Generally Solicit'*, CNN MONEY (Oct. 11, 2013, 7:46 AM), <http://finance.fortune.cnn.com/2013/10/11/the-first-vc-firm-to-generally-solicit/>.

¹³⁷ *2014 Media Guide*, DOW JONES 1, 4–20 (2013), <http://www.dowjones.com/privateequityventurecapital/MediaGuide2014.pdf>.

¹³⁸ *Advertise on VentureBeat*, VENTUREBEAT, <http://venturebeat.com/advertise/> (last visited Feb. 8, 2014).

¹³⁹ Shapiro, *supra* note 132.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

Finally, hedge fund insiders are concerned that their colleagues at other firms will construe an advertisement by their particular fund as a sign of desperation or an indication that business is not going well.¹⁴²

In spite of the fact that private placement advertisements have been slow to catch on, there is indication that private placement issuers support the lifting of the solicitation ban. The Commodity Futures Trading Commission (the “CFTC”),¹⁴³ up until recently, had “a parallel rule that prohibit[ed] the private funds it directly overs[aw] from advertising to the general public.”¹⁴⁴ Thus, someone who took advantage of the advertising ban’s removal would have been at risk of violating the CFTC’s regulations.¹⁴⁵ The Managed Funds Association—the trade group of the hedge fund industry—urged the CFTC to update its rules as far back as 2012.¹⁴⁶ The CFTC initially responded that such steps were not a priority for it,¹⁴⁷ but on September 9, 2014, it eased its restrictions to achieve conformity with the SEC’s rules.¹⁴⁸ Funds subject to CFTC oversight may now advertise after notifying the CFTC of their intention to do so.¹⁴⁹ It is likely that hedge funds, private equity firms, and venture capital entities will take advantage of Title II at some point in the future, given this newfound regulatory uniformity. It is crucial to consider, then, whether the existing regulatory scheme is in good enough shape to ensure that the markets will not be worse off than prior to Title II’s enactment.

¹⁴² *Id.* “[T]he SEC really put the fear in people.” Summers, *supra* note 135 (quoting Mitch Ackles, global president of the Hedge Fund Association, on why no one wanted to be the first to advertise).

¹⁴³ *Mission & Responsibilities*, U.S. CFTC, <http://www.cftc.gov/About/MissionResponsibilities/index.htm> (last visited Dec. 29, 2014) (The CFTC “protect[s] market participants and the public from fraud, manipulation, abusive practices and systemic risk related to derivatives – both futures and swaps – and to foster transparent, open, competitive and financially sound markets.”).

¹⁴⁴ Sarah N. Lynch, *US Hedge Fund Industry Pushing Derivatives Regulator to Lift Ad Ban*, REUTERS (Jan. 8, 2014, 3:28 PM), <http://www.reuters.com/article/2014/01/08/usa-hedgefunds-advertising-idUSL2N0JY21R20140108>; *see also* Andrew Ackerman, *CFTC Eases Hedge-Fund Advertising Ban*, WALL ST. J. (Sept. 9, 2014, 9:10 PM), <http://www.wsj.com/articles/regulator-eases-longstanding-restrictions-on-private-fund-offerings-1410311414>.

¹⁴⁵ Lynch, *supra* note 144.

¹⁴⁶ *Id.* The stance of the Managed Funds Association suggests that, if the CFTC’s regulations mirrored those of the SEC, then private placement issuers would be less reluctant to begin advertising.

¹⁴⁷ *Id.*

¹⁴⁸ Ackerman, *supra* note 144.

¹⁴⁹ *Id.*

V. ACTION NEEDED ON THE PART OF THE SEC AND SOCIETY

A. “*For I can raise no money by vile means.*”¹⁵⁰

Since Congress promulgated Title II, both hedge and private funds have noted the potential to generate a significant amount of capital through advertising.¹⁵¹ In spite of the possibility of fraud and the far-reaching investor protection concerns addressed in Part IV, *supra*, lifting the solicitation ban was necessary. From the companies’ perspective, soliciting is a fact of life in a competitive marketplace. Coextensively, if society values giving people the option of whether and how to spend their money, then Title II should permit advertising as a means of exposing them to the range of possible choices. As the SEC recognized, however, businesses should not have free rein to solicit potential buyers in any manner they see fit. Properly rejecting a completely protectionist view, the SEC, as seen in Part IV.A, *supra*, has taken three protective measures in light of Title II’s mandate to eliminate the advertising prohibition for Rule 506 offerings:¹⁵² (1) verifying, through reasonable steps, that everyone purchasing the securities is accredited;¹⁵³ (2) excluding felons and other bad actors from tendering securities offerings under the new rule;¹⁵⁴ and (3) proposing updates to Form D and restrictions and review requirements on the solicitation materials.¹⁵⁵ While the SEC should be commended for taking steps to control the *source* of the offerings (i.e., by disqualifying felons and other bad actors), further refinement is needed¹⁵⁶ with regard to protecting the *target* of the offerings. Specifically, even though many of the private placements relying on

¹⁵⁰ KENNETH MUIR, SHAKESPEARE’S TRAGIC SEQUENCE 52 (photo. reprint 2005) (1972) (quoting Act IV, Scene III of William Shakespeare’s JULIUS CAESAR).

¹⁵¹ Collectively, the hedge funds that have filed offerings with the SEC since Title II point out that, of the \$18,000,000,000 that can be raised, \$1,400,000,000 could potentially be driven by solicitations. Lynch, *supra* note 144. Similarly, for venture capital and private equity funds that have filed offerings with the SEC since Title II, \$1,800,000,000 of the \$90,000,000,000 could conceivably come from advertisements. *Id.*

¹⁵² See *supra* notes 65–66 and accompanying text.

¹⁵³ See *supra* notes 67 and accompanying text.

¹⁵⁴ See generally *supra* Part IV.A.1.

¹⁵⁵ See generally *supra* Part IV.A.2.

¹⁵⁶ *Venture Capital Investing and JOBS Act*, PEARSON SIMON & WARSHAW, <http://www.pswlaw.com/Practice-Areas/Securities-Litigation/Venture-Capital-Investing-and-JOBS-Act.aspx> (last visited Feb. 8, 2014) (quoting a convicted securities fraudster as stating, “I wish legislators would consult with people like me before they write something like this. I could tell them, I know what your intent was with this wording, but we can get around it so easily, it cracks me up.”).

Regulation D have historically viewed the funds themselves as the “clients,”¹⁵⁷ the term “clients” should now include both the accredited investors that contribute capital to the funds¹⁵⁸ and the people viewing the advertisements.

The SEC’s actions, in their current form, do not adequately safeguard prospective buyers and individuals confronted with solicitations in the marketplace for two reasons. First, the final regulation conflates accredited investors and sophisticated investors.¹⁵⁹ Second, the proposed rule presupposes that more information is necessarily better.¹⁶⁰

By allowing for wide-scale solicitations while restricting sales to accredited investors only,¹⁶¹ updated Rule 506(c) seems to suggest that accredited investors are less susceptible to making erroneous investment decisions in the event that misleading information appears in the advertisements. While this is certainly true in some cases, it is dangerous to generalize. One reason involves the manner in which the statute and regulations define “accredited investors.”¹⁶² In an age where the adult population in the United States has earned over 16 million Master’s degrees, and over 3 million professional and doctoral degrees,¹⁶³ it is not hard to imagine that a large number of people will meet the definition of “accredited investor,” namely, by earning over \$200,000 annually.¹⁶⁴ Although these figures bode well for the level of educational attainment in this country, it does not stand to reason that

¹⁵⁷ See, e.g., Anita K. Krug, *Institutionalization, Investment Adviser Regulation, and the Hedge Fund Problem*, 63 HASTINGS L.J. 1, 28 (2011); Goldstein v. SEC, 451 F.3d 873, 879 (D.C. Cir. 2006) (discussing the ambiguity inherent in the term “client”); see also Anita K. Krug, *The Private Fund Adviser Registration Act: HR-3818*, BERKELEY CTR. FOR LAW, BUS. & ECON. 1, 2 (2009).

¹⁵⁸ Anita K. Krug, *Moving Beyond the Clamor for “Hedge Fund Regulation”: A Reconsideration of “Client” Under the Investment Advisers Act of 1940*, 55 VILL. L. REV. 661, 691 (2010) (suggesting that private funds should regard investors as clients because they have discretion to allot funds to the investment advisor and to act on the basis of information that such advisor provides).

¹⁵⁹ See generally *supra* note 14 and accompanying text; see also *infra* text accompanying notes 162–169.

¹⁶⁰ See, e.g., *supra* notes 80, 82, 88–90 and accompanying text.

¹⁶¹ See *supra* notes 66–67 and accompanying text.

¹⁶² *Id.*

¹⁶³ *Educational Attainment of the Population 18 Years and Over, by Age, Sex, Race, and Hispanic Origin: 2012*, U.S. CENSUS BUREAU, <http://www.census.gov/hhes/socdemo/education/data/cps/2012/tables.html> (last visited Feb. 8, 2014) (select “All Races” XLS file under Table 1). Specifically, of those in the United States age 25 and over in 2012, 16,459,000 held Master’s degrees, 3,093,000 held professional degrees, and 3,178,000 held doctoral degrees. *Id.*

¹⁶⁴ See *supra* notes 119–121 and accompanying text.

all high-achievers are financially savvy. Just because a person has earned an advanced degree and obtained “expert” status in one discipline does not mean that she will readily understand the fundamentals of short-selling, a technique many hedge funds employ.¹⁶⁵ It can happen, of course, but it is not very likely.

Indeed, the SEC has left accredited investors to largely fend for themselves.¹⁶⁶ It has proposed that issuers dump a plethora of information on purchasers in the form of additional items on Form D,¹⁶⁷ legends on solicitation materials,¹⁶⁸ and disclaimers when their ads feature performance data.¹⁶⁹ By doing so, the SEC is assuming—prematurely—that purchasers will not only read what is presented to them, but also understand it and make a decision accordingly.

The SEC has also left the people viewing the advertisements out in the cold. It does not appear to be all that concerned with the impact that this new class of solicitations will have on the general public, perhaps because unaccredited investors will not be able to buy securities offered under Rule 506(c) anyway.¹⁷⁰ What do non-accredited investors stand to gain or lose, then, as a result of viewing these advertisements? They will definitely not incur any of the benefits that flow from a well-informed citizenry. By confronting these advertisements—plastered with disclaimers and warnings¹⁷¹—in the newspaper and on television¹⁷² with the understanding that they cannot participate in the transactions being offered, unaccredited investors are likely to walk away not knowing anything more about private placements than they did prior to Title II. While things that are off-limits tend to have greater allure precisely because they are not easily accessible,¹⁷³ there is also the possibility that non-accredited investors will view Rule 506(c) offerings as something to be feared. Thus, the SEC has not struck the right balance—for both accredited investors and the people viewing the advertisements—between a knowledgeable

¹⁶⁵ See Office of Investor, *supra* note 101, at 2.

¹⁶⁶ Importantly, this Comment does not suggest that accredited investors should not bear ultimate responsibility for their investment decisions. In order to make these decisions, however, the SEC has to ensure that *better* information is made available to them. See *generally infra* Part V.B.

¹⁶⁷ See *supra* notes 79–80 and accompanying text.

¹⁶⁸ See *supra* notes 82–84, 88 and accompanying text.

¹⁶⁹ See *supra* note 89 and accompanying text.

¹⁷⁰ See *supra* text accompanying note 67.

¹⁷¹ See Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44,806–01, 44,822–23 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 230, 239).

¹⁷² See 17 C.F.R. § 230.502(c) (2008).

¹⁷³ See Rodrigues, *supra* note 101, at 3389 and accompanying text.

marketplace and a protected marketplace.

What, then, needs to be done? The answer lies in a two-tiered approach to investor education. While financial literacy programs have come under fire,¹⁷⁴ even those who are generally dubious of such programs admit that “[t]he flaws in research claiming that financial-literacy education is effective do not prove the programs are ineffective”¹⁷⁵ A successful framework for investor education would comprise one track geared towards investors who are currently accredited,¹⁷⁶ and another track tailored toward everyone else¹⁷⁷—any of whom can theoretically become an accredited investor during her life. The approach that either method employs will necessarily differ.

B. Educational Efforts Directed at Investors Who Are Currently Accredited

Regarding educational efforts directed at investors who are currently accredited, both issuers and regulators should be required to furnish these investors with better, not merely additional, information. This will be especially important in the case of investors who are accredited on paper but who have never invested in Rule 506 offerings before. Prior to investing, these “newbies” should be required to indicate to a regulatory body, like the SEC or the Financial Industry Regulatory Authority, how they heard about the particular investment opportunity. Anyone who selects an issuer’s marketing efforts as the reason should then be required to review two types of material: 1) how to recognize fraud;¹⁷⁸ and 2) how to compare one investment device relative to another.¹⁷⁹ Regulatory bodies can take a number of tactics to furnish investors with both types of information; this Comment

¹⁷⁴ See, e.g., Lawrence A. Cunningham, *Behavioral Finance and Investor Governance*, 59 WASH. & LEE L. REV. 767, 791 (2002) (criticizing the general incoherence of such programs); Dana M. Muir, *Choice Architecture and the Locus of Fiduciary Obligation in Defined Contribution Plans*, 99 IOWA L. REV. 1, 9 (2013) (tying financial literacy education to employees’ retirement prospects).

¹⁷⁵ Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197, 210 (2008).

¹⁷⁶ See *infra* Part V.B. The definition of “accredited” in this context would mirror the language of the SEC’s new rule. See 17 C.F.R. §§ 230.506(c) (2) (ii) (A)–(D) (2013).

¹⁷⁷ See *infra* Part V.C.

¹⁷⁸ Securities fraud victims typically do not suffer from financial illiteracy per se, but rather, do not recognize the indicators typically associated with fraud. Jayne W. Barnard, *Deception, Decisions, and Investor Education*, 17 ELDER L.J. 201, 227 (2010).

¹⁷⁹ See Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44,806-01, 44,822-23 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 230, 239); see also *supra* text accompanying note 90.

presents one possibility for each.

Regarding fraud recognition, the SEC can issue a short—and hopefully entertaining—movie clip depicting how bad actors operate and offering tips for what to watch out for.¹⁸⁰ Filming someone clinically reciting the elements of fraud will not be memorable for viewers. Instead, the clips should be recorded in appropriate surroundings and enlist the help of real actors to portray five to ten key scenarios that people may encounter. By injecting a dose of realism into these clips, investors will not only view watching them as less of a chore, but also be more likely to remember them.

In light of the findings that emerged around the SEC's proposed rule, it is equally important to give these investors an idea of how to compare investments. In its proposed rule, the SEC requires that private funds choosing to rely on advertising include notations on their marketing materials clarifying that, *inter alia*, private funds are not required to follow any standard methodology and that a one-to-one comparison of private funds' performance may not be possible.¹⁸¹ Given that investors consider performance to be a deciding factor in choosing whether to take part in an investment,¹⁸² it is curious that the SEC would take the easy way out by sticking a warning on the advertisements.¹⁸³

If, on the other hand, issuers prominently display how consistently their funds perform from one year to the next, then investors will be able to gauge the funds' volatility and make a personal judgment call.¹⁸⁴

¹⁸⁰ See Paula A. Argento, *Comments to the SEC on File S7-21-11 Re: Extending Bad Actor Disqualifications*, U.S. SEC. & EXCH. COMM'N (Aug. 17, 2011), <http://www.sec.gov/comments/s7-21-11/s72111-39.htm>.

¹⁸¹ See, e.g., Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,822–23; *supra* text accompanying note 90. See also *Venture Capital Investing*, *supra* note 156 (“No doubt the persons soliciting these investment [sic] will emphasize the 500 to 1000 times returns made on now iconic companies such as Apple and Google. What they will not tell you is that only 1 out of 10 startups result [sic] in positive returns for venture investors.”).

¹⁸² See *supra* text accompanying note 87.

¹⁸³ The SEC's self-proclaimed mission “is to *protect investors*, maintain fair, orderly, and efficient markets, and facilitate capital formation.” *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM'N, <http://www.sec.gov/about/whatwedo.shtml> (last modified June 10, 2013) (emphasis added).

¹⁸⁴ Presently, regulators are concerned about how much value prospective investors will place on funds' past performance. *Fact Sheet: Proposing Amendments to Private Offering Rules*, U.S. SEC. & EXCH. COMM'N (July 10, 2013), <http://www.sec.gov/news/press/2013/2013-124-item3.htm>. In the retail context, for example, investors assess prospective companies on the basis of the advisors' success in increasing the value of the investors' assets. *Tannenbaum v. Zeller*, 552 F.2d 402, 405 (2d Cir. 1977).

This is particularly important for investors who have not dabbled in private placements before and who may not fully understand the extent to which they differ from retail funds, specifically in the area of risk. Although such measures will not inform investors as to how much profit they can expect, mandatory data on consistency in returns over time will provide a quick means for a prospective purchaser to decide whether Fund X aligns with his individual comfort level for volatility, compared to Fund Y.

Upon taking both of these steps, the investor should be made to certify that he or she has completed the review and to complete a brief “quiz” of five to ten questions, before being permitted to invest as he or she wishes. Accredited investors who already participate in Rule 506 offerings, however, should not be required to go through these same steps. Rather, they should be made aware that this material is available. Issuers can help in this regard. For example, hedge fund investment advisors typically enjoy a personal relationship with each investor due to the longstanding private placement rules.¹⁸⁵ Using what they know about their clients, they can highlight the benefits of accessing the material by translating it into something that they know their clients value, e.g., entering everyone who reviews the information into a drawing for a dinner party at a Michelin-starred restaurant.

C. Educational Efforts Directed at the General Population

In terms of educational programs intended for the general population, there must be a push to create a culture of financial literacy—rather than of information overload—beginning in elementary schools and continuing throughout the formal education system. The shocking statistic that an estimated less than four percent of Americans are *fully* capable of comprehending investment products and asset allocations misses the mark.¹⁸⁶ Ensuring that every citizen achieves an all-encompassing understanding of the financial market’s inner workings is a pipe dream at best. Yet, most of the Americans who will encounter the general solicitations are arguably capable of becoming conversant in basic finance. Elementary school health classes frequently strive to illustrate the benefits of eating balanced meals, and colleges routinely require students to earn a certain number of credits in disciplines like English in order to graduate. Ensuring that future generations of Americans are healthy and able to speak properly are certainly worthy goals; is it not just as critical to

¹⁸⁵ Cable, *supra* note 23, at 134.

¹⁸⁶ Barnard, *supra* note 178, at 226–27.

provide them with the tools to look out for their own financial welfare?¹⁸⁷ Financial literacy needs to be prioritized to a similar extent—through mandatory coursework—if the investment landscape is, indeed, changing.¹⁸⁸

Fortunately, tools are already available for schools to either use or model their own efforts on. TheMint, an interactive website designed to assist parents and teachers in instructing children on how to manage money and be financially responsible,¹⁸⁹ is a prime example of a tool that can be used in elementary and middle schools. Among other things, the site offers easy-to-read material on mutual funds¹⁹⁰ as well as opportunities to practice writing checks.¹⁹¹ LearnVest, an online site that offers personalized financial advice with apps that users can access from their iPhones,¹⁹² provides a similar model for high school and college students, many of whom have part-time jobs. It provides unlimited phone and email access to a financial planner who routinely issues actionable challenges in line with users' goals.¹⁹³

Moreover, there is reason to be optimistic about the ability of private placement issuers to realize these suggestions. Because hedge funds, unlike mutual funds, lack boards of directors, additional investor protection measures may be easier for the former to implement.¹⁹⁴ As an added bonus, “the financial-services industry uniformly supports financial-literacy initiatives, both rhetorically and with multimillion-dollar donations”¹⁹⁵

¹⁸⁷ A survey of 18- to 24-year-olds who rent found that more than 20% of the group spends at least \$100 more than it earns every month. Martha C. White, *Today's Young Adults Will Never Pay Off Their Credit Card Debts*, TIME BUS. & MONEY (Jan. 17, 2013), <http://business.time.com/2013/01/17/todays-young-adults-will-never-pay-off-their-credit-card-debts/>. Further, individuals born between 1980 and 1984 have more than \$5,689 “in credit card debt than their parents did at that age.” *Id.*

¹⁸⁸ See *supra* text accompanying notes 60–62.

¹⁸⁹ *About the Mint*, THEMINT, <http://www.themint.org/about/> (last visited Mar. 24, 2015).

¹⁹⁰ *Mutual Funds*, THEMINT, <http://www.themint.org/teens/mutual-funds.html> (last visited Mar. 24, 2015).

¹⁹¹ *Writing a Check*, THEMINT, <http://www.themint.org/teens/writing-a-check.html> (last visited Mar. 24, 2015).

¹⁹² *Our Mission*, LEARNVEST, <http://www.learnvest.com/about/> (last visited Mar. 24, 2015); *How It Works*, LEARNVEST, <https://www.learnvest.com/personal-financial-planning-program/> (last visited Mar. 24, 2015).

¹⁹³ *How It Works*, *supra* note 192.

¹⁹⁴ Anita K. Krug, *Investment Company as Instrument: The Limitations of the Corporate Governance Regulatory Paradigm*, 86 S. CAL. L. REV. 263, 278 (2013).

¹⁹⁵ Willis, *supra* note 175, at 209.

In a society that prides itself on offering countless opportunities for upward mobility—where the students of today may well be the accredited investors of tomorrow—personal knowledge is perhaps the supreme source of empowerment. Shifting the balance of power from brokers to members of the investing public in this way better equips the latter to take on an active role in managing their financial lives. Knowledgeable investors benefit from securities regulation because of their awareness that brokers must cater to them when selecting investments.¹⁹⁶

An important caveat underlying these suggestions for both accredited investors and the people viewing the advertisements, however, is that education is a two-way street. Individuals may have the most up-to-date, accurate information at their fingertips, but unless they put the time in to reinforce the material, they will have little, if anything, to show for it. As a result, it is crucial to understand that taking these measures will not necessarily immunize people from making poor investment decisions.¹⁹⁷ Although issuers and regulatory bodies should be responsible for furnishing accredited investors and the people viewing advertisements with the *right kind of* information, in the end, the onus should be on investors to make informed decisions on the basis of the tools they have available.

VI. CONCLUSION

Title II of the JOBS Act and the corresponding SEC regulations have ushered in a new wave of advertising efforts that the public has never been confronted with before. Permitting issuers transacting in Rule 506 offerings to solicit to the general public is a necessary step to ensuring the freedom of businesses to compete and the freedom of individuals to make investments (or not) as they see fit. At the same time, placing no restrictions on marketing strategies has the potential to ignite a firestorm of fraud and investor safety concerns. The SEC correctly recognized these dangers in the final and proposed rules it put forth concurrently with lifting the advertising prohibition.

¹⁹⁶ Chelsea P. Ferrette, *The Myth of Investor Protection: The Dodd-Frank Act and the Office of the Investor Advocate*, 12 J. BUS. & SEC. L. 61, 69 (2011).

¹⁹⁷ “The ill-educated and unfocused often fail. . . . some will win big, some will lose big, but most will live comfortable lives in the middle.” Bill O’Reilly, *Hating the Rich*, BILL O’REILLY (May 17, 2012), <http://www.billoreilly.com/newsletter/column?pid=37019>.

2015]

COMMENT

611

Although these protective measures are a step in the right direction, they do not go far enough. Separate investor education programs, one geared at investors who are currently accredited and another targeted at the general population, respectively, must be put in place if the solicitation ban's repeal is to be a positive step for securities regulation. While the emphasis of the accredited investor program should be on identifying fraud and evaluating consistency in returns over time, the program directed at the general population should champion widespread financial literacy. By leading the charge to supply both groups with better information, the SEC will move closer to protecting the markets by empowering society to protect itself.